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Fiduciary Duty of Directors: Your Role in Governing Your HOA

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Focused on Communities

Fiduciary Duty of Directors

- Duty of Care
- Duty of Loyalty
- Duty to Act Within the Scope of Their Authority

Duty of Care

- Directors of HOAs have same duty of care as directors of corporations.

- Duty of Care Requires Directors to:
  - Act with the care of an ordinary prudent person;
  - Act in the best interests of the Association; and
  - Act in good faith.

Fulfilling the Duty of Care

- Attend Meetings
- Be Prepared
- Ask Questions
- Obtain Advice from Professionals as Necessary
- Be Informed Before Acting
- Exercise Independent Judgment

Duty of Loyalty

- Duty of Loyalty to the Association as a Whole

- Duty of Loyalty Means Interests of Association are Above:
  - Your Personal Interests;
  - Your Neighbor's Interests;
  - Your Families Interests;
  - The Interests of Another Group or Entity

Fulfilling the Duty of Loyalty

- Debate issues openly and passionately;
- Permit owners to provide input before making tough decisions;
- Once a decision is made – speak with one voice;
- Handle conflicts of interest appropriately

Conflicts of Interest Policy

Definitions:

- “Conflict of Interest” means circumstances exist which may unduly influence a Director’s decision on a Board action.

- “Conflicting Interest Transaction” means any contract, transaction of financial relationship between:
  - Association and Director;
  - Association and Person Related to a Director:
  - Association and Entity in which the Director is also a Director or Officer of the Entity *or* Has a Financial Interest in the Entity.

Conflicts of Interest Policy Continued. . .

- No Loans to Board Members

- Disclosure of Conflict of Interest *and* Conflicting Interest Transactions
  - Director must disclose any Conflict of Interest in any matter affecting the HOA
  - Prior to the Association entering into a Conflicting Interest Transaction, Director must describe in an open meeting any potential conflicting interest transaction;
  - Other Directors who (in good faith) believe another Directors has a Conflict of Interest or potential Conflicting Interest Transaction, may disclose this during and open meeting and disinterested Directors should make a determination.

- Taking Action Upon Disclosure
  - Director with conflict can be counted for purposes of quorum;
  - Director with conflict cannot participate in discussions;
  - Director with conflict cannot vote.

Conflicts of Interest Policy Continued. . .

- Validity of a Conflicting Interest Transaction:
  - Conflicting Interest Transaction is not invalid solely because:
    - The transaction involves a Director, a person related to a Director, or an entity in which the Director is an officer, director or has a financial interest;
    - The Director is present at and participates in the meeting where the transaction was approved; *or*
    - The Director's vote is counted if:
      - The conflicting interest transaction is disclosed or known before the conflicting interest transaction is approved by the Disinterested Directors (even if no quorum); *or*
      - The conflicting interest transaction is disclosed or known before the conflicting transaction is approved by Directors entitled to vote; *or*
      - The conflicting transaction is fair to the Association.

Conficts of Interest Policy Must Be Reviewed Periodically By the Association

Conflicts of Interest

Perception is Reality

Duty to Act Within Scope of Authority

- Scope of Authority Granted by Governing Documents
  - Articles of Incorporation
  - Bylaws
  - Condominium Declaration/Declaration of Covenants, Conditions & Restrictions

- Scope of Authority Granted by Statute
  - Colorado Common Interest Ownership Act
  - Colorado Revised Nonprofit Corporation Act

Fulfilling the Duty to Act Within Scope of Authority

- Sniff Test
- Always consult governing documents
- Consult applicable statutes
- Consult with legal counsel if unsure whether you have authority or the scope of your authority.

Examples of Breach of Fiduciary Duty

- Failure to maintain, replace or repair common property
- Failure to plan for and fund reserves;
- Failure to appropriately budget;
- Failure to collect delinquent assessments;
- Failure to protect Association funds;
- Failure to file required reports and returns;
- Failure to enforce use restrictions;
- Failure to enforce governing documents uniformly

These are examples and not an exhaustive list.

Protection of the Business Judgment Rule

The good faith acts of directors of profit or non-profit corporations which are within the powers of the corporation and within the exercise of an honest business judgment are valid.

Rywalt v. Writer Corp., 526 P.2d 316,317 (Colo. App. 1974)

Other Protections for Directors

- D&O Coverage
- Indemnification of Directors
- Transparency and Good Communications With Owners

Alternate Dispute Resolution

- Philosophy: Try to keep out of court if possible.
  - Better control over the outcome
  - Cheaper than court action

- Types of ADR:
  - Negotiation
  - Mediation
  - Arbitration

Colorado Law Encourages Use of Mediation in HOA Disputes

Policy Regarding Dispute Resolution

- Addresses disputes or claims involving the Association and/or the Association's governing documents.
- Prior to proceeding to Court with a claim, the person asserting the claim ("Claimant") must give all opposing parties ("Respondents") notice which includes:
  - Nature of the Claim;
  - Legal or contractual basis of the Claim; and
  - What they want.

Policy Regarding Dispute Resolution Continued . . .

- Once Respondent receives notice of the Claim, the parties should get together to attempt to negotiate a resolution.
- If the parties cannot negotiate a resolution to the Claim within 60 days, the Claimant has 60 days to submit the Claim to mediation.
  - If parties cannot agree to a mediator, a mediator will be appointed by the District Court;
  - If Claimant doesn't submit the Claim to mediation within the 60 days or doesn't show up at mediation – the Claimant waives the Claim and Respondent is released and discharged of all liability.
  - Mediation settlements must be in writing and signed by the parties.
  - Each party responsible for own costs of mediation and shall split equally the cost of the mediator.
  - If no resolution from mediation, Claimant can file a Court action.
  - Prevailing party gets attorney fees and costs.

Policy Regarding Dispute Resolution Continued. . .

- Disputes and Claims NOT subject to the Policy:
  - Collection of assessments
  - Restraining orders or injunctions necessary to prevent immediate threat to persons or property;
  - Any actions between homeowners that do not include the Association;
  - Any action to enforce a settlement agreement.

Policy Regarding Dispute Resolution Continued. . .

- Statutes of Limitations:
  - If a statute of limitations *is going to run*, Claimant doesn't have to comply with this Policy.
  - If a statute of limitations has *already run*, Claimant cannot bring a claim or dispute under this Policy for resolution.

- Dispute Resolution Policy does not supersede Covenant Enforcement Policy

Tips for Preventing Disputes

- Give owners a heads-up on tough issues early on and keep them informed
- Make sure to hold open meetings and be transparent
- Give owners an opportunity to be heard prior to making decisions.
- Really *listen* to owners
- Don’t let ego or anger get in the way
- Don’t be a bully
- Always, always act in the best interests of the Association

Happy Halloween!

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